



## AICPA Investment Companies Expert Panel

July 18-19, 2022, meeting highlights

### I. Accounting/Reporting Issues:

1. The EP considered the following scenario: An adviser for an existing private equity fund that launched in the prior year has established a new parallel fund due to additional investor interest that cannot be accommodated in the existing fund. The existing fund and the parallel fund will share the same investment strategy. Upon commencement of operations of the parallel fund, a portion of the investments of the existing fund will be sold to the parallel fund based on the pro rata share of the capital commitments of the parallel fund relative to the combined capital commitments of both funds. In addition, the parallel fund will compensate the existing fund for its proportionate share of certain expenses that were previously incurred by the existing fund, as well as for a deferred interest charge calculated based on an annual rate applied to the cost of the investments acquired from the existing fund. The EP noted diversity in practice in accounting and discussed the following:
  - 1) whether the cost basis of the investments acquired by the parallel fund (initial recognition) should be recorded based on the original cost basis recorded by the existing fund or based on the fair value as of the date of acquisition.
  - 2) whether the existing fund should record the proportionate share of expenses compensated by the parallel fund as other income, as a contra-expense, or as a capital contribution.
  - 3) observations of how the deferred interest charge is recorded (e.g., as income to the fund or to the investors of the existing fund).

Certain EP members expressed a view that, presuming that the transfer from the existing fund to the new fund met the conditions in ASC 860 *Transfers and Servicing*, for sale accounting, the investments would be derecognized from the existing fund with a realized gain/loss and recorded by the new fund at the acquisition price (i.e., the acquisition price paid by the new fund to acquire those investments). One EP member expressed a view that in accordance with ASC 946-320-30-1 the new fund would record the investments acquired from the existing fund at the transaction price, which could be viewed to include amounts paid for the deferred interest. Another EP member expressed a view that the amounts paid for the deferred interest are more akin to a financing charge that would be recorded by the new fund as interest

expense. The contractual arrangement driving the incremental payment should be reviewed and analyzed in considering the appropriate treatment. EP members also discussed the guidance around transfers between entities under common control and agreed that if the funds are under common control, the new fund would carry over the cost basis of the investments acquired from the existing fund.

The EP members also discussed potentially presenting combined financial statements for the two funds, if appropriate.

The EP also considered whether any incremental amounts received by the existing fund to compensate for a portion of its expenses would be reflected in the statement of operations or the statement of changes in partners' capital of the existing fund. The EP members noted that they have seen diversity in practice and the transaction would follow the methods and terms stipulated by the limited partnership agreement. EP members agreed that funds should include a narrative disclosure about the transaction and consider disclosing the impact on the ratios in the financial highlights, as well as the IRR.

In connection with this discussion, one EP member pointed to the SEC's increased focus on cross trades and the compliance with the fund's established policies and procedures. Another EP member observed that the SEC's proposed rule impacting private funds includes potential incremental requirements for adviser-led secondary transactions.

2. The EP discussed recent developments related to Russian sanctions, particularly in regard to ruble-denominated payments on certain Russian securities. Certain entities have begun to receive ruble-denominated proceeds in their custodial accounts that they do not have access to. The EP members discussed how to account for these proceeds and whether they meet the characteristics of cash from the FASB's master glossary, which includes the characteristic that customers should be able to deposit and withdraw funds at any time without prior notice or penalty. As these ruble denominated proceeds do not seem to meet the characteristics of cash, the EP discussed whether accounting for these proceeds as a receivable at net realizable value would be more appropriate.
3. The EP considered a scenario where a fund has an investment in another fund measured at fair value using the NAV practical expedient, where the net assets of the investee fund has a deficit balance as a result of the fair value of the investee fund's portfolio companies decreasing below the amount of debt held by the investee fund. The investee is organized as a limited partnership with a capital call structure, and the investor fund has unfunded and uncalled capital commitments to the investee fund. The EP considered whether an investment in another fund in this scenario can be recorded as a liability under the NAV practical expedient. The EP members discussed that if a legally binding capital commitment associated with the deficit exists, it may be appropriate to record a liability. The EP members also discussed a view that if the investor fund is not legally obligated to fund the deficit, there may be situations where the investment should not be valued below zero and not recorded as a liability. One EP member shared that presenting the investment in the financial statements as a negative investment, instead of a liability, may be justified when viewing the deficit

as immaterial and having the expectation that such investment will revert from a negative balance in the short term.

4. The EP discussed potential implementation issues from the issuance of FASB ASU 2022-03 *Fair Value Measurement of Equity Securities Subject to Contractual Sale Restrictions*. The EP members discussed potential challenges around gathering the information necessary to produce the new disclosure requirements within the ASU, such as obtaining information from various groups/departments. The EP also discussed the potential need to disclose two accounting policies for investment companies, as a result of the specialized adoption for investment companies that the ASU provides, which requires discounts to continue to be applied to equity securities with contractual restrictions executed prior to the adoption date of the ASU if that was consistent with the fund's accounting policy prior to adoption. Lastly, the EP members also discussed a situation where a fund complex holds both US GAAP and IFRS entities and whether the ASU would cause diversity in the measurement of fair value between entities that report under US GAAP vs. those that report under IFRS. The EP will continue this discussion in a future meeting as investment companies begin to adopt the ASU.

## II. Audit and Attest:

1. The EP reviewed draft summary of applicable audit, attest, and independence standards for certain engagements in investment companies/investment management industry. Update: the [summary](#) is now available.

## III. AICPA/Administrative:

1. The EP members considered timing and proposed conforming changes to the AICPA Audit and Accounting Guide *Investment Companies*.
2. AICPA Investment Companies Expert Panel May meeting highlights are being finalized.

## IV. SEC Staff Update Disclaimer

**The following comments and observations were compiled by the AICPA Investment Companies Expert Panel and AICPA staff and are not authoritative positions or interpretations issued by the SEC or its staff. The comments and observations were not transcribed by the SEC or its staff and have not been considered or acted upon by the SEC or its staff. Accordingly, these comments and observations do not constitute a statement of the views of the SEC or its staff.**

1. Mark T. Uyeda and Jaime Lizárraga have been sworn in as SEC Commissioners.
2. Speeches and statements by SEC Commissioners and staff:
  - a. June 8, 2022, [The Critical Importance of the General Standard of Auditor Independence and an Ethical Culture for the Accounting Profession](#) by Paul Munter, Acting Chief Accountant
  - b. Single stock ETFs (July 11, 2022):
    - [Statement on Single-Stock Levered and/or Inverse ETFs](#) by Lori J. Schock, Director, Office of Investor Education and Advocacy

- [Statement on Single-Stock ETFs](#) by Commissioner Caroline A. Crenshaw

3. The SEC staff highlighted several investment management topics included in the SEC [Spring 2022 regulatory agenda](#), including amendments to custody rule for investment advisers, amendments to fund names rule, third-party service providers, ESG, open-end fund liquidity, fund fee disclosure, money market fund reform, amendments to Form PF, and tailored shareholder reports, among others.
4. The SEC staff offered additional feedback on the EP members' prior conversations with the SEC regarding fee waivers/reimbursements paid by advisers to fund of funds in excess of total expenses. Specifically, situations in which investment advisers of registered fund of funds may enter into expense limitation agreements whereby they limit the total expenses of a fund of fund, inclusive of acquired fund fees and expenses (AFFE) of underlying fund investments (also see [May 2014 EP and May 2022 EP - Fee Waivers/Reimbursements in Excess of Total Expenses by Advisers to Fund-of-Funds for additional information](#)).

The Staff reiterated its view that the reimbursement should be evaluated based on the facts that gave rise to the reimbursement, but generally would not expect the reimbursement to result in a negative net expense. The SEC staff acknowledged that several presentation options for fee waivers/reimbursements may be justified depending on the facts and circumstances, and reminded registrants to present the amount of reimbursement in the financial statement section most closely associated with that reimbursement and support such presentation with appropriate disclosures.

5. Recent Proposed rules:
  - a. Names Rule - The proposed amendments to the Names Rule would enhance the current rule, which requires registered investment companies whose names suggest a focus in a particular type of investment (among other areas) to adopt a policy to invest at least 80% of the value of their assets in accordance with the name it implies, by requiring more funds, including business development entities (BDCs), to adopt an 80% investment policy and includes additional terms in the fund name that would need to meet the requirement.
  - b. Enhanced Disclosures by Certain Investment Advisers and Investment Companies about ESG Investment Practices (IM ESG) - The proposed ESG rules and form amendments seek to categorize certain types of ESG strategies broadly, and require registered investment companies, BDCs, registered investment advisers, and certain unregistered investment advisers to provide more specific disclosures in fund prospectuses, annual reports, and adviser brochures based on the ESG strategies they pursue.

The SEC staff provided a reminder that the Names Rule and the IM ESG proposals are separate and distinct proposals. The comments for both proposals were due August 16, 2022.

Additional information about the proposed **Names Rule** is available in the [press release](#), [fact sheet](#), and [proposing release](#).

Additional information about the proposed **IM ESG Rule** is available in the [press release](#), [fact sheet](#), and [proposing release](#).

6. S-X Rule 6-11(b)(2) sets the requirements for determining whether financial statements and supplemental information of an individual fund acquired or to be acquired are to be filed:
  - “...using the conditions specified in the definition of significant subsidiary in §210.1-02(w)(2)(i) and (w)(2)(ii)(B)...substituting 20 percent for 10 percent each place it appears therein...”

The income test under 1-02(w)(2)(ii) includes an instruction that permits a registrant to compute the primary and alternate income tests using the average of the absolute value of the changes in net assets for the past five fiscal years:

“...if the absolute value of the change in net assets resulting from operations of the registrant and its subsidiaries consolidated is at least 10 percent lower...”

The EP members inquired whether the five year averaging provision should be applied at the 20 percent threshold for purposes of Rule 6-11. The SEC staff would not expect registrants to substitute 20 percent for 10 percent when determining whether they are permitted to use five-year averaging in computing the income test for purposes of Rule 6-11.

7. The Division of Examinations (“EXAMS”) has issued [risk alert “Investment Adviser MNPI Compliance Issues”](#) to provide investment advisers, investors, and other market participants with information concerning notable deficiencies that the staff has cited related to Section 204A (“Section 204A”) of the Investment Advisers Act of 1940 (the “Advisers Act”) and Rule 204A-1 (the “Code of Ethics Rule”), which require all investment advisers registered with the SEC to adopt a code of ethics.
8. Enforcement cases against:
  - a. [June 29, 2022, a dually registered investment adviser and broker-dealer for failure to implement policies and procedures in connection with a complex investment strategy, including inadequate training and oversight over its advisors.](#)
  - b. [June 28, 2022, public accounting firm matter](#) for integrity failures related to ethics exams
  - c. [June 3, 2022, investment adviser to the AlphaCentric Income Opportunities Fund for failure to implement its policies and procedures relating to the valuation of securities held by the Fund](#)
  - d. [May 25, 2022, fund and its sole owner, Andrew M. Middlebrooks, for allegedly engaging in a multi-year scheme that included the misappropriation and misuse of investors’ funds](#)
  - e. May 25, 2022, the SEC’s [first-ever enforcement proceeding under Section 11 of the Investment Company Act of 1940 for improper switching or replacing of variable annuities to generate sales commissions](#)

- f. [May 23, 2022, investment adviser for misstatements and omissions about Environmental, Social, and Governance \(ESG\) considerations in making investment decisions for certain mutual funds that it managed](#)

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